

*International Tax Treaties*

MAXIMUM TIME: 2 HOURS  
MAXIMUM POINTS: 100  
DECEMBER 12, 2007, 1:30 P.M., ROOM 1550

**Instructions**

1. **Write your examination number**, the name of this course (Int'l Tax Treaties), and the name of the instructor (McIntyre) in the appropriate spaces on your **bluebook**. Please do this now. Do **not** put your own name or any information on your personal status (i.e., graduating senior, graduate student) anywhere on the bluebook. If your examination number is not in the upper right corner of this page, please put it there.
2. *Thank you for putting your exam number and other information in the appropriate spaces.* This is an **open book** examination. You are expected to have with you the course materials for each class, including a copy of the OECD Model Treaty (2003 with updates from class web site) and the U.N. Model Treaty (2001). You are permitted to have any books, notes, commercial outlines, or other materials you have used during the course. You may use a pocket calculator.
3. This examination has three (3) parts. Part I has essay questions, Part II has Multiple Choice questions, and Part III has True/False questions. The answers to the essay questions go in your bluebook. The answers to the Multiple Choice and True/False questions should be marked directly on your copy of the examination.

**NOTE TO PROCTOR:**

All copies of the Examination **MUST** be returned to you by the end of the examination period. Please check carefully to be sure you can account for all copies. Persons allowed to leave the examination room **for any reason** must leave their copy of the examination with you to hold until they return.

## Exam

*Instructions.* Answer the following two (2) questions in your bluebook. Write in ink on every other line (double spaced), do not write on the back side of any page, and **do not write in the margins**. Observe the maximum space limitations. *You will suffer a grade penalty, proportionate to the offense, for exceeding the space limitations.* (As a practical matter, a penalty is not imposed for exceeding the limits by two lines or less.) One page of a bluebook, double spaced, is 14 lines.

*Note on Handwriting.* A person with normal-sized handwriting typically gets about 10 to 12 words per line. Make an appropriate adjustment if your handwriting is unusually large or small. Please, do not count your words.

**Note to typists:** Put your exam number in the upper right hand corner of each page of your answer sheets. Number your answers clearly and observe the space limits. One handwritten line of normal size writing is equivalent to 1 line of a typed page (8½" × 11") with 1½ inch margins (pica) or 2 inch margins (elite). This notice is typed with a pica font (Courier 12 point) and has 1½ inch margins.

A.

(Maximum Points: 18; Maximum Lines: 28)

SCo (subsidiary) is a U.S. corporation, organized under Delaware law. It is a wholly-owned subsidiary of NCo (parent), an internationally famous engineering firm, organized under the laws of the Netherlands. For purposes of this question, please assume that the United States taxes SCo on its worldwide income and that the Netherlands only taxes NCo on income derived in the Netherlands. Also assume that the United States and the Netherlands have a tax treaty based on the OECD Model Tax Convention.

The U.S. Army Corps of Engineers has contracted with NCo and SCo to construct waterworks that would protect Fort Myers, Florida, from a Class 5 hurricane. The expected payments under the contract exceed \$5 billion. The U.S. Corps of Engineers has insisted that it contract with NCo through a U.S. affiliate, in this case, SCo. SCo will be in charge of managing the project and will post bond guaranteeing against cost overruns and other matters. The contract between SCo and the U.S. Army Corps of Engineers provides that SCo will receive a bonus of \$100 million if it meets the proposed completion date of July 2009.

NCo expects that SCo will earn a net profit, before payments to NCo, of \$400 million. NCo hopes, however, to strip out \$100 million of those expected profits by requiring SCo to make royalty

payments to it of that amount for use of its know-how. SCo has obtained advice from its transfer-pricing expert that a charge of \$100 million for the know-how can be justified under U.S. and Dutch law and under Article 9 of the U.S.-Netherlands treaty. You should assume this advice is sound.

For SCo to be able to construct the proposed waterworks, it will need the assistance of engineers currently on the payroll of NCo. NCo is reluctant to move the engineers from its payroll to that of SCo because of pension issues. It is expected that 5 engineers from NCo will be required. One of the engineers will be needed for the entire project, which is expected to take 18 months to complete. The other engineers will be required for shorter periods, none exceeding 5 months. All of the engineers wish to avoid being taxed by the United States.

NCo comes to you for tax advice regarding the U.S.-Netherlands tax treaty. Answer each of the questions below based only on the treaty.

**Question 1(a).** (9 points, 14 lines)

NCo wants very much to avoid having a PE in the United States. Do you think that NCo is likely to have a PE in the United States under the U.S.-Netherlands treaty? Explain the risks and the steps you recommend for NCo and SCo to take for NCo to avoid having a PE in the United States. Give explicit references to provisions of the treaty.

**Question 1(b).** (9 points, 14 lines)

Can some or all of the engineers on the payroll of NCo avoid being taxed by the United States under the U.S.-Netherlands treaty? Explain. Give explicit references to provisions of the treaty.

**B.**

**(Maximum points: 18; maximum lines: 28)**

Excerpts from Article 5 (Permanent Establishment) of the New Zealand Model Tax Convention (2006) are set forth below.

Note: [...] means that the actual time period will be set through negotiations. For purposes of this exam, please assume the missing time period is 6 months.

**Excerpts from New Zealand Model Tax Convention, Art. 5, Para. 3-5**

3. A building site, or a construction, installation or assembly project, or supervisory activities in connection with that building site or construction, installation or assembly project, constitutes a permanent establishment if it lasts more than [...] [e.g., 6 months].
4. An enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if:
  - (a) for more than [...] [e.g., 6 months]:
    - (i) it carries on activities which consist of, or which are connected with, the exploration or exploitation of natural resources, including standing timber, situated in that State; or
    - (ii) substantial equipment is being used in that State by, for or under contract with the enterprise; or
  - (b) it furnishes services (including consultancy and independent personal services), but only where activities of that nature continue within the State for a period or periods exceeding in the aggregate 183 days in any 12 month period commencing or ending in the year of income concerned.
5. For the purposes of determining the duration of activities under paragraphs 3 and 4, the period during which activities are carried on in a Contracting State by an enterprise associated with another enterprise shall be aggregated with the period during which activities are carried on by the enterprise with which it is associated if the first-mentioned activities are connected with the activities carried on in that State by the last-mentioned enterprise, provided that any period during which two or more associated enterprises are carrying on concurrent activities is counted only once. An enterprise shall be deemed to be associated with another enterprise if one is controlled directly or indirectly by the other, or if both are controlled directly or indirectly by a third person or persons.

**Question 2.** (18 points, 28 lines)

Consider the associated-enterprise rule set forth in paragraph 5, above, of Article 5 (Permanent Establishment) of the New Zealand Model Tax Convention. Should this rule be adopted for Article 5 of the OECD Model Tax Convention? Discuss the policy reasons for favoring or not favoring this associated-enterprise rule, and explain how it differs from the OECD's current associated-enterprise rule in Article 5.

## II. Multiple Choice Questions (maximum points: 24)

Mark your choice of alternative answers to each question by circling its identifying letter **on your copy of the exam**. Do **NOT** circle more than one alternative answer per question. Your score will be based on the number of correct answers. No points are deducted for incorrect answers. Each question is worth 4 points.

If you believe that unstated facts are crucial to your answer, or if you believe that a question is ambiguous, go ahead and answer the question as best you can. Then circle the number of the question on the question sheet and, on the space provided on the last page of this exam, identify the unstated facts or the ambiguities and explain their relevance to the question. If your grounds for challenging a question are well-founded and if you have properly shown the relevance of an alleged omission of fact or ambiguity to the answer, you will receive full credit for your answer. There are no intentional ambiguities or omissions of necessary facts.

*Warning: If you decide to explain your answer, you do so at your own risk. You will receive **no credit** for circling what I have judged to be the correct answer to a question if you have challenged that question and your grounds for doing so are unfounded or incorrectly stated.*

[Multiple Choice Questions Omitted]

## III. True/False Questions (maximum points: 40)

Mark your choice of alternative answers to each question by circling its identifying letter on your copy of the exam. Each right answer is worth 2 points. There is no penalty for wrong answers.

[True/False Questions Omitted]